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### Estate Tax—Validity of a Levy on Life Insurance Policies Issued Before Passage of Estate Tax Where Right to Change Beneficiary Reserved (Heiner v. Grandin (3rd Cir. 1930))

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### SECURITIES ATTORNEYS FACE LIABILITY FOR WRONGS OF THEIR CORPORATE CLIENTS

Traditionally, claims against lawyers for the wrongful actions of their corporate clients were valid only if the attorney was a primary participant in the offense.<sup>1</sup> Recently, injured investors have sought to hold attorneys who serve corporate clients secondarily liable for the illegal actions of those clients when the attorney renders legal services,<sup>2</sup> with knowledge of those actions.<sup>3</sup> Modern cor-

<sup>1</sup> See, e.g., *United States v. Benjamin*, 328 F.2d 854, 863 (2d Cir. 1964) (lawyer considered active participant and liable in fraud based on procurement of broker for conspiratorial scheme and preparation of false list of assets and opinion letters), *cert. denied*, *Howard v. Benjamin*, 377 U.S. 953 (1964); *In re Investors Funding Corp. of N.Y. Sec. Litig.*, 566 F. Supp. 193, 202 (S.D.N.Y. 1983) (claims allowed against attorney alleging direct involvement in illegal diversion of funds); *United States v. Schwartz*, [1970-71 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 93, 023 (E.D.N.Y. 1971) (lawyer considered active participant in unlawful hypothecation because he arranged and financed fraudulent transaction, personally guaranteed repayment and supervised unlawful public offering); *Adams v. American Western Sec., Inc.*, 265 Or. 514, 510 P.2d 838, 844-45 (1973) (lawyer considered active participant in sale of security if he prepared, executed, personally delivered and filed documents of registration with knowledge sale had already been made); *Strahan v. Rodney*, 97 Cal. App. 2d 448, 217 P.2d 711, 713 (Cal. Ct. App. 1950) (attorney, who was also director and secretary of corporation, liable for fraudulent sale of stock because he voted to make, prepared and signed application for permit of issuance).

Historically, successful actions against lawyers involved with securities transactions went far beyond mere claims that the attorney failed to fulfill his professional responsibility. See Lowenfels, *Expanding Public Responsibilities of Securities Lawyers: An Analysis of the New Trend in Standard of Care and Priorities of Duties*, 74 COLUM. L. REV. 412, 413-416 (1974). These traditional actions placed the lawyer at the center of a blatant fraud, and then positioned him as a primary actor at the "fulcrum of fraudulent activity." *Id.* at 413. In contrast, claims against lawyers who did not "scheme to defraud" but who were involved in the formulation and execution of the transaction as counsel and advisor were not successful. *Id.* See, e.g., *Nicewarner v. Bleavins*, 244 F. Supp. 261, 266 (D. Colo. 1965) (attorney did not step out of role as professional counsel, and therefore was not liable, although services were vital to transaction); *Hughes v. Bie*, 183 So. 2d 281, 283-84. (Fla. Dist. Ct. App. 1966) (lawyer's preparation and execution of legal documents insufficient to render him liable).

<sup>2</sup> See DeBenedictis, *Lawyer Deep Pockets: Attorneys Face Malpractice Claims for Clients' Dubious Deals*, 76 A.B.A. J. 34, 34 (Jan. 1990). "More and more, people injured in dubious financial deals are suing the lawyers who represented the deal makers. And more and more, courts are letting them do it . . ." *Id.* Attorneys who worked on deals that went sour are increasingly expected to serve as scapegoats for disappointed shareholders. See Jensen, *Deals May Backfire for Firms; Beyond Malpractice*, Nat'l. L.J., Jan. 16, 1989, at 1.

Plaintiffs allege that day to day activities, such as aiding in the preparation of materials for a public offering or rendering legal opinions, constitute sufficient participation for liability. See, e.g., *SEC v. Electronics Warehouse, Inc.*, 689 F. Supp. 53, 60 (D. Conn. 1988), *aff'd sub. nom.*, *SEC v. Calvo*, 891 F.2d 457 (2d Cir. 1989), *cert. denied*, 110 S. Ct. 3228 (1990) (attorneys may be liable as aiders and abettors of client's fraud if documents drafted include erroneous information or material omissions); *Arden Way Assocs. v. Boesky*, 664 F. Supp. 855, 857 (S.D.N.Y. 1987) (claims asserted against attorney defendants who ren-

porate practice facilitates this trend by encouraging and allowing attorneys to participate in the decision-making processes and to sit on the board of directors of their corporate clients.<sup>4</sup>

A predominant legal theory utilized in the attempt to hold attorneys secondarily liable is "aiding and abetting" client misconduct.<sup>5</sup> To prove that a defendant attorney aided and abetted a

dered legal opinions and prepared prospectus containing deficiencies); *Seidel v. Public Serv. Co. of New Hampshire*, 616 F. Supp. 1342, 1360-62 (D.N.H. 1985) (law firm liable for preparation and dissemination of misleading materials). See generally Reycraft, *Conflicts of Interest and Effective Representation: The Dilemma of Corporate Counsel*, 39 HASTINGS L.J. 605, 612-613 (1988) (describing recent actions against corporate and securities lawyers).

<sup>4</sup> See *SEC v. Washington County Util. Dist.*, 676 F.2d 218, 224 (6th Cir. 1982). Knowledge is a requirement which must be satisfied to find that one aided and abetted another's wrong. *Id.* Generally, "a person may be held as an aider and abettor only if some other party has committed a securities law violation . . . and if the accused aider-abettor knowingly and substantially assisted the violation." *Id.* (citing *SEC v. Coffey*, 493 F.2d 1304, 1316 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975)) (emphasis added)). See also *In re Citisource, Inc. Securities Litigation*, 694 F. Supp. 1069, 1082-83 (S.D.N.Y. 1988) (cause of action for securities violation dismissed because status as special counsel alone will not infer requisite scienter); *Vereins-Und Westbank, A.G. v. Carter*, 639 F. Supp. 620, 623 (S.D.N.Y. 1986) (preparation of falsified documents alone will not infer knowledge of fraud without allegation attorneys knew statements to be false); *Mendelsohn v. Capital Underwriters, Inc.*, 490 F. Supp. 1069, 1088 (N.D. Cal. 1979) (preparation of documents does not infer knowledge or reckless indifference to fraud). But see *Rolf v. Blyth, Eastman, Dillon & Co.*, 570 F.2d 38, 44 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978) (lawyer without actual knowledge may be liable if he disregarded wrongful action); *SEC v. Frank*, 388 F.2d 486, 489 (2d Cir. 1968) (attorney who has no actual knowledge of fraud may be liable if found he should have known); *Kilmartin v. H.C. Wainwright & Co.*, 580 F. Supp. 604, 608 (D. Mass. 1984) (court refused to dismiss claims against attorney holding that knowledge of fraud may be averred generally).

<sup>5</sup> See Jensen, *supra* note 2, at 1. The litigation explosion against attorneys is keeping pace with the expansion of attorneys' roles. *Id.* Lawyer liability for deals that go bad "comes with the territory as business advisor to the deal-makers" and the "investment-banker-type fees some law firms are charging . . ." *Id.* See, e.g., *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 575-76 (E.D.N.Y. 1971) (attempt to dispose of case failed since lawyer had nominal position in management); *Escott v. Barchris Constr. Corp.*, 283 F. Supp. 643, 689-92 (S.D.N.Y. 1968) (attempt to dispose of case by averring lack of knowledge failed since lawyer sat on board of directors). See generally Reycraft, *supra* note 2, at 614-15 (discussing lawyers susceptibility to lawsuits when they actively participate in their client's business).

<sup>6</sup> See Comment, *Aiding and Abetting Liability Under Securities Exchange Act Section 10(b) and SEC Rule 10b-5: The Infusion of A Sliding-Scale, Flexible-Factor Analysis*, 22 LOY. L.A.L. REV. 1189, 1191 (1989) [hereinafter Comment, *Aiding and Abetting Liability*]. Aiding and abetting liability has become increasingly important in securities violations situations where a primary violator is insolvent and a remotely connected potential defendant, such as an attorney, has the ability to pay the judgment. *Id.* See, e.g., *Rolf*, 570 F.2d at 44 (2d Cir. 1977) (attorney liable as aider and abettor), *cert. denied*, 439 U.S. 1039 (1978); *Arden Way Assocs. v. Boesky*, 664 F. Supp. 855 (S.D.N.Y. 1987) (action brought against Fried, Frank, Harris, Shriver & Jacobson for allegedly aiding and abetting fraud of Ivan Boesky). *In re Allied Stores Corp.*, [current] Fed. Sec. L. Rep. § 84, 142 (June 29, 1987) (SEC alleged

client's fraud, the plaintiff must prove knowledge of a primary violation and substantial assistance by the corporate attorney.<sup>6</sup> Technically, aiding and abetting liability requires counsel to overstep his or her role as corporate counsel and to aid in the fraud.<sup>7</sup> Often, the facts and issues concerning specific attorney action are not tried in court, however, because attorneys negotiate and pay large settlements fearing irreparable damage to their firm's reputation.<sup>8</sup>

attorney/director of Sullivan & Cromwell aided and abetted fraud). *See also infra* note 6 and accompanying text (discussing aiding and abetting liability).

An alternate legal theory which frequently arises in attorney liability actions is counsel as a "controlling person" within the corporation. *See* § 20(a) Securities Exchange Act of 1934, 15 U.S.C. § 78t(a). The 1934 Act provides:

Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person . . . is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

*Id.*

Case law has further defined "control." *See* Seidel v. Public Serv. Co. of New Hampshire, 616 F. Supp. 1342, 1361-62 (D.N.H. 1985). In this case, the district court of New Hampshire defined a "controlling person" as one having power to direct the action and policy of another and therefore participate in some sense in the action. *Id.* The Seidel court noted that corporations generally follow attorney advice. *Id.* at 1362. *See also* Pharo v. Smith, 621 F.2d 656, 670 (5th Cir. 1980) (approving SEC definition of "control" as "possession . . . of the power to direct or cause the direction of the management and policies of a person"); Gould v. American-Hawaiian S.S. Co., 535 F.2d 761, 779 (3d Cir. 1976) (defined as "influence short of actual direction"); Cammer v. Bloom, 711 F. Supp. 1264, 1295 (D.N.J. 1989) (endorsing "control by status" approach); American Gen. Ins. Co. v. Equitable Gen. Corp., 493 F. Supp. 721, 751 (E.D. Va. 1980) (control includes ability to influence person's decision-making process).

<sup>6</sup> *See* Stokes v. Lokken, 644 F.2d 779, 782-83 (8th Cir. 1981). The three-part test for determining aiding and abetting liability requires: (1) the existence of a securities law violation by the primary party (as opposed to the aiding and abetting party); (2) "knowledge" of the violation on the part of the aider and abettor; and (3) "substantial assistance" by the aider and abettor in the achievement of the primary violation. *Id.* (citing IIT, An Int'l Inv. Trust v. Cornfeld, 619 F.2d 909 (2d Cir. 1980)). *See also* Norman v. Brown, Todd & Heyburn, 693 F. Supp. 1259, 1264 (D. Mass. 1988) (stating common law definition of aiding and abetting as variation of joint tort liability); First Fed. Sav. and Loan Assoc. of Pittsburgh v. Oppenheim, Appel, Dixon & Co., 634 F. Supp. 1341, 1351-53 (S.D.N.Y. 1986) (discussing elements required to find aiding and abetting liability); *infra* notes 34-48 and accompanying text (discussing aiding and abetting liability).

<sup>7</sup> *See* Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490, 496 (7th Cir. 1986) (substantial assistance means "more than just a little aid"). Wright v. Schock, 571 F. Supp. 642, 663 (N.D. Cal. 1983) (substantial assistance is more than mere "ministerial tasks"). *See generally* Comment, *Aiding and Abetting Liability*, *supra* note 5, at 1203-08 (discussing conduct which constitutes aiding and abetting).

<sup>8</sup> *See* Tabac, *Crossfire at the Bar*, New York Times, May 3, 1987, § 6, (Magazine) at 30, col. 1, at 50. One commentator approximates that 85 percent of all legal malpractice suits

This Survey will illustrate the trend toward secondary liability of attorneys by initially focusing on several prestigious law firms who have paid for their client's wrongs. This Survey will then explain the legal theories utilized to reach the corporate attorney. Finally, it will suggest the reasons for and the impact of the liability trend, and proper attorney action for avoidance of suit.

## I. THOSE WHO PAY THE PRICE

Attorney as defendant is a growing phenomenon in suits alleging a violation of securities law.<sup>9</sup> This trend has a damaging effect on attorneys and law firms, including those attorneys who profess their innocence.<sup>10</sup> Three very prestigious law firms, namely: Kaye, Scholer, Fierman, Hays and Handler [Kaye Scholer]; Lord, Bissell and Brook [Lord Bissell]; and Rogers and Wells, recently entered settlement negotiations which clearly illustrate the trend and its consequences.<sup>11</sup>

### A. *Kaye, Scholer, Fierman, Hays and Handler*

In June of 1990, Kaye Scholer agreed to a twenty million dollar settlement with investors who were injured by the alleged fraud of Kaye Scholer's client, Lincoln Savings and Loan.<sup>12</sup> Lincoln Sav-

are settled before trial. *Id.* This is true in part because lawyers do not make good witnesses and jurors are often prejudiced against the profession. *Id.* See also *infra* notes 11-32 and accompanying text (examples of settlements).

\* See Lowenfels, *supra* note 1, at 412 (discussing "growing body of law that is expanding the duties and responsibilities of attorneys under the federal securities laws"); Reycraft, *supra* note 2, at 606 (noting "growing number of lawsuits being brought against lawyers and law firms engaged in the practice of corporate and securities law"); Comment *Aiding and Abetting Liability*, *supra* note 5, at 1191-92 ("[r]ecently, the concept of Aiding and Abetting has become increasingly important in federal securities violations"). See, e.g., *Stevens v. Equidyne Extractive Indus.* 1980, Petro/Coal Program 1, 694 F. Supp. 1057 (S.D.N.Y. 1988) (tax opinion letter of counsel resulting in potential securities law liability); *SEC v. Electronics Warehouse, Inc.*, 689 F. Supp. 53 (D. Conn. 1988) (potential securities law liability if attorney prepares misleading documents); *Excalibur Oil, Inc. v. Sullivan*, 616 F. Supp. 458 (D.C. Ill. 1985) (potential securities action against attorney under Rule 10b-5 for failure to prepare title opinions).

<sup>10</sup> See *infra* notes 11-32 and accompanying text (examples of admit-no-guilt settlements by very prestigious law firms).

<sup>11</sup> See *infra* notes 12-32 (illustrating trend). See generally Marcus, *Risk of Ethics Litigation Raises Ante for Blue-Chip Law Firms*, Wash. Post, May 26, 1987, Metro, at B1, Col. 2 ("where once only shady sole practitioners or fly-by-night firms ended up being defendants, today's targets of lawsuits include some of the nation's largest and most prestigious firms").

<sup>12</sup> See *Law Firm in Lincoln S & L Suit Agrees to Pay \$20 Million*, San Francisco Chron.,

ings and Loan filed for bankruptcy<sup>13</sup> after which plaintiffs pointed the finger at professionals,<sup>14</sup> including Kaye Scholer, who they alleged aided and abetted a scheme to mislead investors<sup>15</sup> by assisting in the preparation of a misleading initial prospectus for debenture bonds<sup>16</sup> and clearing unsafe bonds for sale.<sup>17</sup>

Kaye Scholer contended that several viable defenses would have proven their innocence at trial.<sup>18</sup> Kaye Scholer attorneys charac-

June 16, 1990. Lincoln Savings and Loan issued debenture bonds and investors claimed they were misled to believe the bonds were federally insured. *Id.* at A6. See also *Law Firm Settles for \$20 Million; Fraud Alleged in Keating Company Bond Sales*, Bus. Ins., June 25, 1990, at 38 [hereinafter *Law Firm Settles*] (reporting settlement by Kaye Scholer).

<sup>13</sup> See Riley, *Tainted Bond? Lincoln Savings and Loan's Law Firm Accused of Helping its Client Fleece Public*, Newsday, March 11, 1990 (Business) at 64. "After fending off a federal takeover in 1988, Lincoln collapsed like a house of cards in 1989 amid allegations of insider loans, tax cheating and political fixing." *Id.*

<sup>14</sup> See *S & L Scandal Snares a Big Firm*, Nat'l L.J., May 29, 1989 at 3. Kaye Scholer was one of several professional firms named as defendants in the complaint alleging fraud on the part of American Continental Corp. and its subsidiary, Lincoln Savings and Loan. *Id.* Two law firms also named in the suit were Chicago-based Sidley & Austin and the Los Angeles law firm of Parker, Milliken, Clark, O'Hara & Samuelian. See *Law Firm Settles*, *supra* note 12, at 38. The other defendants consisted of three accounting firms including Arthur Young & Co. and its legal successor by merger, Ernst & Young; Arthur Andersen & Co.; and Touche Ross & Co. and its legal successor by merger, Deloitte & Touche. *Id.*

<sup>15</sup> See *Law Firm Settles*, *supra* note 12, at 38. Plaintiff's allegations included that: (1) Kaye Scholer "knowingly assisted" defendants in a scheme to make debentures appear safe and sound; (2) the firm forged documents to cover Lincoln's improper practices; and (3) Kaye Scholer lent "credibility" to unsound debenture bonds by permitting use of the Kaye Scholer name in connection with the public offering. *Id.* See also *infra* notes 16-17 and accompanying text (discussing allegations against Kaye Scholer).

<sup>16</sup> See *Law Firm in S & L Suit Agrees to Pay \$20 Million*, *supra* note 12, at A6 (discussing Kaye Scholer's role in creation of initial prospectus); *Law Firm Reportedly Agrees to \$20 Million Settlement*, 267 Sacramento Bee 1228, June 4, 1990, §A, at 1. (plaintiffs labelled Kaye Scholer "principal drafter" of false prospectuses and filings).

<sup>17</sup> See Riley, *supra* note 13, at 60. Kaye Scholer was alleged to have been aware of the risk that some bonds were "unsafe" and "unsound" and the law firm allegedly cleared these bonds for sale to "unsuspecting investors." *Id.*

<sup>18</sup> *Id.* at 60-62. Possible defenses included: (1) Kaye Scholer merely drafted legal documents and therefore fulfilled its role as attorney; (2) it was the accountants responsibility to clear financial statements in the prospectuses; (3) no wrongdoing of Kaye Scholer's client was proved in court; and (4) certain materials stated that the bonds were not insured. *Id.*

The primary question faced by Kaye Scholer was whether the firm engaged in solely legal duties or went beyond their duties as counsel and assisted a fraud. *Id.* at 60. Kaye Scholer denied involvement in any improper transactions. *Id.* Legal experts note that Kaye Scholer had a solid defense concerning even the firm's attempt to defend the client against federal regulators as long as Kaye Scholer "simply fought the good fight against regulators and didn't participate in any fraudulent or improper activities that Lincoln may have been involved in." *Id.*

See also *Lincoln Will Pay \$20 Million to Settle RICO Claims by Bondholders*, 55 Banking Rep. (BNA) No. 3, at 114 (firm denies wrongdoing or responsibility for losses); *Law Firm in S & L Suit Agrees to Pay \$20 Million*, *supra* note 12, at A6 (same).

terized the suit as "frivolous" and "ridiculous".<sup>19</sup> Nonetheless, Kaye Scholer agreed to a settlement after considering the cost of trial, and the fact that settlement was fully covered by insurers.<sup>20</sup>

### B. *Lord, Bissell and Brook*

In October of 1989, Lord Bissell agreed to a twenty-four million dollar settlement to clear the law firm of charges of racketeering and aiding and abetting the alleged fraud of National Mortgage Equity Corporation [NMEC].<sup>21</sup> Lord Bissell, a partner of which held a significant financial interest in this client corporation,<sup>22</sup> allegedly ignored evidence of NMEC's fraudulent activities,<sup>23</sup> including the client's alleged use of fictitious appraisers, buyers and lenders and the alleged retention of a near-bankrupt insurer to guarantee loans.<sup>24</sup> Lord Bissell denied any wrongdoing.<sup>25</sup> Nonetheless, the firm negotiated a settlement in order to

<sup>19</sup> See *S & L Scandal Snarcs a Big Firm*, *supra* note 14, at 3. An American Continental Corp. spokesman explained that the suit in state court against the law firms "is so ridiculous that they are afraid to bring it in federal court because of Rule 11 [sanctions]." *Id.*

<sup>20</sup> See *Law Firm Settles*, *supra* note 12, at 38. "Kaye Scholer admits no wrongdoing and says that defending the suit caused 'a substantial drain' on resources." *Id.* (quoting letter from firm to its employees). Kaye Scholer also decided to settle recognizing the sympathetic position of the plaintiffs. *Id.* The law firm also considered the unfriendly California forum where most bonds were issued. See *Lincoln Firm Will Pay \$20 Million to Settle RICO Claims by Bondholders*, 55 Banking Rep. (BNA) No. 3, at 114.

<sup>21</sup> See O'Brien, *Some Firms Never Learn*, Am. Lawyer, Oct. 1989, at 63. Lord Bissell settled after they were accused of involvement in their client's dubious scheme. *Id.* Lord Bissell's client, NMEC, was engaged in the practice of obtaining residential mortgages, putting them in pools and issuing mortgage backed certificates which they claimed were supported by a triple layer of protection. See *It's Not Over for Lord Bissell*, Chicago Trib., Feb. 16, 1988, (Business) at 3 (Sports Final ed.). The NMEC certificates were very attractive in that: (1) they offered yields up to 18 percent; (2) they were backed by property; (3) NMEC and the brokers certified the borrower's ability to pay and the property backing the loans; and (4) insurers wrote bonds on each mortgage. O'Brien, *supra* at 64. Before the close of 1984, however, the pools had either collapsed or were stocked with defaulted loans. *Id.* NMEC was alleged to have carried out a "Massive Ponzi-Scheme." *Id.*

<sup>22</sup> See O'Brien, *supra* note 21, at 64. Leslie Michael, a partner at Lord Bissell was a founder and a major shareholder in the client corporation, NMEC. *Id.*

<sup>23</sup> See O'Brien, *supra* note 21, at 64-65 (discussing NMEC's alleged activities and warning that Lord Bissell partners received and ignored).

<sup>24</sup> See *It's Not Over For Lord Bissell*, *supra* note 21, at 3. The claim also alleged that the law firm failed to act to protect investors and allegedly wrote letters supporting NMEC. See O'Brien, *supra* note 21, at 35.

<sup>25</sup> See *It's Not Over For Lord Bissell*, *supra* note 21, at 3. A Lord Bissell partner, Joseph Coughlin, stated that the firm had not engaged in any type of fraud. *Id.*

avoid a "messy trial" and negative publicity.<sup>26</sup>

### C. *Rogers and Wells*

In April of 1986, Rogers and Wells entered into an admit-no-guilt settlement<sup>27</sup> when it agreed to pay forty million dollars<sup>28</sup> in response to charges which stemmed from the fraud of their client, "San Diego swindler J. David Dominelli,"<sup>29</sup> who sold unregistered securities to numerous disappointed investors.<sup>30</sup> The suit against Rogers and Wells alleged that the firm aided and abetted the fraud by continuing to represent and assist Dominelli after its attorneys should have known of the fraud.<sup>31</sup> Rogers and Wells entered negotiations which resulted in the painful settlement to avoid defense costs and the cost of negative publicity.<sup>32</sup>

## II. LAWYER AS AIDER AND ABETTOR

A typical legal theory used in actions attempting to hold corporate attorneys secondarily liable for their clients' actions is lawyer as aider and abettor of the wrong.<sup>33</sup> Plaintiffs often allege that securities attorneys are secondarily liable as aiders and abettors of securities violations under Section 10(b) of the Securities Exchange Act of 1934<sup>34</sup> and Rule 10b-5 promulgated thereunder.<sup>35</sup>

<sup>26</sup> See O'Brien, *supra* note 21, at 64-67 (discussing Lord Bissell's settlement).

<sup>27</sup> See Tabac, *supra* note 8, at 47 (discussing Rogers and Wells' settlement).

<sup>28</sup> See Galante, *After \$40 Million Payment, It's Not Over Yet for Rogers & Wells*, Nat'l L.J., Apr. 14, 1986, at 1, col. 1. This was called the "largest malpractice settlement ever reported." Reycraft, *supra* note 2, at 605.

<sup>29</sup> See DeBenedictis, *supra* note 2, at 34 (labeling Dominelli a "San Diego swindler").

<sup>30</sup> See *Lincoln Faces Formidable Foe*, 267 Sacramento Bee 43397, Feb. 25, 1990, § H at 1. Investors lost more than \$80 million. *Id.* at 1. Other professional firms sued in connection with the Dominelli fraud include the law firm of Wiles, Circuit & Tremblay and the Laventhol & Horwath Accounting Company. See *Bilked Investors Win Suit Against Law Firm, Attorney*, L.A. Times, Aug. 28, 1987, part 4, at 1, col. 1.

<sup>31</sup> See Tabac *supra* note 8, at 47 (discussing alleged wrongful conduct of Rogers & Wells); Galante, *supra* note 28, at 1 (same).

<sup>32</sup> See Galante, *supra* note 28, at 36-37 (discussing settlement); Galante, *Last 'J. David' Firm Agrees to Pact: Rogers & Wells Still Under Fire*, Nat'l L.J. April 13, 1987, at 3 (discussing additional battles faced by Rogers & Wells and advantages of settlement alternative).

<sup>33</sup> See *supra* note 5 and accompanying text (discussing aiding and abetting as predominant legal theory).

<sup>34</sup> Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78(j)(b)(1982). This section makes it unlawful "[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public



This Rule makes it unlawful for anyone to defraud or deceive another in connection with the sale or purchase of a security.<sup>36</sup> To prove aiding and abetting liability under SEC Rule 10b-5, the plaintiff must show: (1) a primary violation of Section 10(b) by a main actor; (2) knowledge of the primary violation; and (3) substantial assistance.<sup>37</sup>

Aiding and abetting liability, as applied to attorneys, is exemplified in *First Federal Savings and Loan Association of Pittsburgh v. Oppenheim, Appel, Dixon & Co.* [*First Federal Savings and Loan*].<sup>38</sup> In *First Federal Savings and Loan*, the Southern District Court of New York held that an attorney could be liable as aider and abettor of his client's fraud for advising the client to continue its behavior and for counseling the client's accountant not to act against the fraud.<sup>39</sup>

The client securities dealer was found guilty of fraud in an earlier litigation.<sup>40</sup> The client later brought suit against his own accountant for aiding and abetting in the securities law violation.<sup>41</sup> The accountant, in turn, impleaded the defendant law firm for

interest or for the protection of investors." *Id.*

<sup>36</sup> 17 C.F.R. § 240.10b-5 (1988). Rule 10b-5 states:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality . . . of any facility of any national securities exchange, (a) To employ any device, scheme or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with purchase or sale of any security.

*Id.*

<sup>38</sup> *Id.* See also *LHLC Corp. v. Cluett, Peabody & Co., Inc.*, 842 F.2d 928, 932-33 (7th Cir.) (discussing aiding and abetting liability under section 10(b) and Rule 10b-5), *cert. denied*, 488 U.S. 926, (1988); *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 494-96 (7th Cir. 1986) (same).

<sup>37</sup> See *SEC v. Coffey*, 493 F.2d 1304, 1315-1318 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975) (stated most frequently used version of three part aider-abettor liability test); *IIT, An Int'l Inv. Trust v. Cornfeld*, 619 F.2d 909, 922 (2d Cir. 1980) (discussing elements for aiding and abetting liability); *Woodward v. Metro Bank*, 522 F.2d 84, 93-97 (5th Cir. 1975) (same). See also *supra* note 6 and accompanying text (discussing elements of aiding and abetting liability). See generally Comment, *Aiding and Abetting Liability*, *supra* note 5, at 1198-99.

<sup>38</sup> 634 F. Supp. 1341 (S.D.N.Y. 1986).

<sup>39</sup> *First Fed. Sav. and Loan*, 634 F. Supp. at 1351-53.

<sup>40</sup> *Wichita Fed. Sav. & Loan Assoc. v. Comark*, 586 F. Supp. 940 (S.D.N.Y. 1984), *reargued*, 610 F. Supp. 406 (S.D.N.Y. 1985), *aff'd*, 810 F.2d 1161 (S.D.N.Y. 1986).

<sup>41</sup> See *First Fed. Sav. & Loan*, 634 F. Supp. at 1343.

contribution based on the identical legal theory.<sup>42</sup>

The accountant alleged that the defendant law firm aided and abetted in the securities violation by providing legal advice which encouraged the securities dealer to continue its fraudulent behavior.<sup>43</sup> The accountant argued that the law firm's advice to the accountant to maintain his position without disclosing the client's fraud and without fear of liability were acts of an aider and abettor.<sup>44</sup> The court, after reviewing the elements which constitute aiding and abetting liability, held that the allegations were sufficient to state a claim.<sup>45</sup>

The court in *First Federal Savings and Loan* is among several lower courts that have expressed a willingness to hold attorneys secondarily liable under the aiding and abetting liability theory.<sup>46</sup> The United States Supreme Court has labelled aiding and abetting liability an open question as applied to securities fraud and misrepresentation.<sup>47</sup> Nonetheless, lower courts have increasingly utilized this legal theory to find corporate attorneys secondarily liable and have given the theory considerable legitimacy.<sup>48</sup>

<sup>42</sup> *Id.*

<sup>43</sup> *Id.* at 1344.

<sup>44</sup> See *First Fed. Sav. & Loan Assoc. of Pittsburgh v. Oppenheim, Appel, Dixon & Co.*, 634 F. Supp. 1341, 1344 (S.D.N.Y. 1986). See generally Reycraft, *supra* note 2, at 606. "[S]uits against lawyers are more frequently being brought by persons who were not themselves clients of the lawyers, but who nonetheless claim that the lawyers have breached a duty owed to them." *Id.*

<sup>45</sup> See *First Fed. Sav. & Loan*, 634 F. Supp. at 1351-53.

<sup>46</sup> See, e.g., *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 44 (2d Cir. 1977) (attorney liable as aider and abettor), *cert. denied*, 439 U.S. 1039 (1978); *Kilmartin v. H.C. Wainwright & Co.*, 580 F. Supp. 604, 608 (D. Mass. 1984) (denying attorney's motion to dismiss claims for aiding and abetting fraud). Cf. *IIT, An Int'l Inv. Trust v. Cornfeld*, 619 F.2d 909, 922 (2d Cir. 1980) (alleging accountant and underwriter liable for aiding and abetting).

<sup>47</sup> See *Herman & Maclean v. Huddleston*, 459 U.S. 375, 379 n.5 (1983). "While several Courts of Appeals have permitted aider-and-abettor liability . . . we specifically reserved this issue . . ." *Id.* (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 191-92 n.7 (1976)). See also Comment, *Aiding and Abetting Liability*, *supra* note 5, at 1192.

The Supreme Court of the United States has never validated the use of aiding and abetting as a proper theory of liability under Rule 10b-5; thus, there may be doubt as to its continued viability. However, the lower courts appear to have established the legitimacy of aiding and abetting.

*Id.*

<sup>48</sup> See *supra* note 46 and accompanying text (citing cases which utilized aiding and abetting legal theory).

## III. ATTORNEY LIABILITY TREND ANALYSIS

A. *Reasons for and Development of the Trend*

The increase in cases involving attorneys named as defendants is a result of an expansion of attorney involvement in corporate decisionmaking and business competition among law firms.<sup>49</sup> Plaintiffs, recognizing the deep pockets of corporate attorneys,<sup>50</sup> take advantage of a modern corporate lawyer's potential involvement in a client's action<sup>51</sup> and the law firm's compromise of professionalism in its desire to maximize business.<sup>52</sup>

Considering today's fast paced corporate world with its demanding deadlines, attorneys often find themselves at the fulcrum of corporate decisionmaking.<sup>53</sup> As a result, attorneys are perceived as the conscience of complex corporate clients and as frequent participants in a client's wrong.<sup>54</sup> Unfortunately, attorneys find inadequate guidance from the Model Code of Professional Respon-

<sup>49</sup> See Marcus, *supra* note 11, at B1. Legal ethics experts "cite changing attitudes toward lawyers, the difficulty of monitoring conflicts of interest and maintaining high ethical standards in the modern-day mega-firm of several hundred lawyers, and the increasingly feverish competition for business among firms" as leading to an explosion of litigation. *Id.* See also Reycraft, *supra* note 2, at 607 (discussing reasons for trend).

<sup>50</sup> See Comment, *Aiding and Abetting Liability*, *supra* note 5, at 1191 n.12. "A deep pocket defendant is a party commonly referred to in many areas of the law as a defendant who has a vast reserve of readily available cash which could be used to satisfy a judgment." *Id.* See also *infra* notes 67-68 and accompanying text (discussing lawyer as "deep pocket" defendant because of liability insurance).

<sup>51</sup> See *infra* notes 53-58 and accompanying text (discussing expanding attorney roles).

<sup>52</sup> See *infra* notes 59-65 and accompanying text (discussing increasing competition among law firms).

<sup>53</sup> See ABA Committee Discusses Kern Ruling, *Internationalization, SEC Amicus Briefs*, 20 Sec. Reg. & L. Rep. (BNA) No. 46, at 1786 (Nov. 25, 1988) [hereinafter *Kern Ruling*]. This report discussed *In re Allied Stores Corp.*, ["1987 decisions"] Fed. Sec. L. Rep. (CCH) ¶ 84,142 (June 29, 1987), a case in which the SEC alleged that attorney/director Kern made a decision not to amend the Schedule 14D-9 and disclose information regarding takeover negotiations as required by law. *Id.* The report revealed an argument made by Dennis Block, Weil Gotshal & Manges: "the fast breaking developments in takeover fights often makes it impossible, for all practical purposes, for counsel not to assume the same role Kern held." See *Kern Ruling*, 20 Sec. Reg. & L. Rep. (BNA) at 1787. See also Marcus, *supra* note 11, at B1 ("in many complex financial situations, lawyers are prominent players").

<sup>54</sup> See generally Burke, *The Duty of Confidentiality and Disclosing Corporate Misconduct*, 36 Bus. Law. 239, 253-60 (1981). Society expects attorneys to simultaneously promote social mores and protect corporate clients. *Id.* "[B]ig ticket litigation" against attorneys alleged to be participants in a corporation's wrong "will keep pace with the expansion of attorney's roles." Jensen, *supra* note 2, at 1 (quoting Richard Greenfield, a leading shareholder's rights attorney).

sibility<sup>55</sup> and the Model Rules of Professional Conduct<sup>56</sup> in determining their proper role as a corporate lawyer.<sup>57</sup> Thus, unguided corporate attorneys often end up as defendants based on actions which may exceed the role of counsel.<sup>58</sup>

A rise in competition among law firms has contributed to this increase in liability.<sup>59</sup> Competition has led to an increase in attorney advertising,<sup>60</sup> the desire for favorable publicity<sup>61</sup> and a compromise of professionalism.<sup>62</sup> In response, plaintiffs have sought to hold attorneys liable not merely as professionals, but as businessmen.<sup>63</sup> The argument is that law firms should not reap the bene-

<sup>55</sup> MODEL CODE OF PROFESSIONAL RESPONSIBILITY (1980).

<sup>56</sup> MODEL RULES OF PROFESSIONAL CONDUCT (1983).

<sup>57</sup> See Reyecraft, *supra* note 2, at 608. "The Model Code fails to provide detailed guidelines for lawyers engaging in the practice of corporate or securities law. How such lawyers should perceive their role and responsibilities in providing corporate counseling is a question on which the Model Code is remarkably silent." *Id.* See also HAZARD, *ETHICS IN THE PRACTICE OF LAW* 9 (1978) (criticizing code's simplistic treatment of complex issues); Burke, *supra* note 54, at 279 ("very few provisions of the code directly address the problems of lawyers representing corporate clients").

<sup>58</sup> See *supra* notes 12-32 and accompanying text (discussing attorney as defendant).

<sup>59</sup> See Reyecraft, *supra* note 2, at 606-07. Firms are pressured to compete for the business of large corporate clients which adds to the increased number of lawsuits filed against lawyers. *Id.* See also Gillers, *Ethics that Bite: Lawyers' Liability to Third Parties*, 13 LITIGATION J. 8, 12, 63 (Winter 1987) (discussing change in liability standards for attorneys because of competition); *infra* notes 60-64 and accompanying text (discussing increased lawyer liability as result of competition).

<sup>60</sup> See *Bates v. State Bar of Ariz.*, 433 U.S. 350, 377-78 (1977). Advertising has become a powerful tool used to penetrate the legal market ever since constitutional protection was afforded to attorney advertising in 1977. *Id.* at 381. See generally Gillers, *supra* note 59, at 12, 63 (discussing ramifications of *Bates*).

<sup>61</sup> See Gray, *More Lawyers Reluctantly Adopt Strange New Practice-Marketing*, Wall St. J., Jan. 30, 1987, at 25, col. 3. Law firms are known to hire public relations experts to highlight victories and downplay defeats. *Id.*

<sup>62</sup> See Symposium: *Legal Ethics in the Age of Marketing*, Legal Times of Washington, July 22, 1985, at 32. Attorneys view themselves as a business to the extent that "you do have to have more numbers on the credit side than the debit side to keep practicing the profession." *Id.* See also Reyecraft, *supra* note 2, at 606-08 (listing various factors involved in deterioration of profession's image); Garth, *Rethinking the Legal Professions' Approach to Collective Self-Improvement: Competence and the Consumer Perspective*, 1983 WIS. L. REV. 639, 657 (1983) (traditional outlook on legal profession adversely affected by "price competition and advertising").

<sup>63</sup> See Reyecraft, *supra* note 2, at 607. Viewing law firms as businesses takes away "aura of protection and trust" they previously enjoyed. *Id.* See also Gillers, *supra* note 59, at 12. "A profession may be able to make a claim for favored status where a business cannot. Increased willingness to hold law firms to liability standards like those that encumber businesses is partly the result of an altered conception of law practice as being in fact a business." *Id.*; Schneycor, *Professionalism and Public Policy: The Case of House Counsel*, 2 GEO. J. LEGAL ETHICS 449, 449-50 (1988). Sociologists label this phenomenon "deprofessionalization." *Id.* See generally Rothman, *Deprofessionalization: The Case of Law in America*, 183

fits of advertising and running a competitive business without compromising the limited liability typically granted only to professionals.<sup>64</sup>

An increase in business competition has driven some attorneys to compromise their positions and ethical responsibilities in an attempt to appease corporate clients who provide the bulk of their revenues.<sup>65</sup> It is submitted that such compromised behavior opens another door to a plaintiff in suit against an attorney.

Plaintiffs have found potential gaps in attorney ethics which they are utilizing to position the attorney as a defendant.<sup>66</sup> Attorneys are attractive defendants since large law firms usually carry sizeable liability insurance policies.<sup>67</sup> Adversaries recognize the "deep pockets" of their attorney opponent particularly when the corporate defendant is bankrupt.<sup>68</sup>

(1974) (discussing the effects of deprofessionalization on legal profession).

<sup>64</sup> See Gillers, *supra* note 59, at 63. "You cannot easily be a business for purposes of the First Amendment and a profession for purposes of liability." *Id.* See also *supra* note 63 and accompanying text (discussing business versus profession). But see Levine, *Self-Interest or Self-Defense: Lawyer Disregard of the Attorney-Client Privilege for Profit and Protection*, 5 HORSTRA L. REV. 783, 829 (1977) (untrusting view of legal profession should permit attorney to defend livelihood and competence without "be[ing] perceived as self-serving").

<sup>65</sup> See generally Marcus, *supra* note 14. "Experts . . . cite economic pressures on firms that may lead lawyers to knowingly violate ethics rules, issue risky opinions or shade their judgment in their economic favor." *Id.* at B1.

See also Reycraft, *supra* note 2, at 606-07. An increased number of law firms are specializing to meet the needs of large corporate clients. *Id.* As a result, a rise in litigation involving law firms as defendants has occurred. *Id.* at 607. This is essentially due to adverse interests arising between present and former clients as well as from claims of attorney malpractice. *Id.*

<sup>66</sup> See *supra* notes 12-32 and accompanying text (illustrating attorney as defendant).

<sup>67</sup> See Marcus, *supra* note 11, at B1 (plaintiffs are becoming aware of lawyer's large insurance policies); Jensen, *supra* note 2, at 1 (same); DeBenedictis, *supra* note 2, at 34 (law firms' liability insurance makes them attractive defendants); Reycraft, *supra* note 2, at 607 (same). See also Gray, *Under Fire: Regulators, the Courts and Clients Bear Down on Lawyers*, Wall St. J., Aug. 21, 1987, at 17, Col. 3 (same). See, e.g., Cronin v. Midwestern Oklahoma Dev. Auth., 619 F.2d 856 (10th Cir. 1980) (insured lawyer named as defendant).

<sup>68</sup> See Jensen, *supra* note 2, at 1. "If a client enterprise fails, the disappointed investors, lenders, and all other third parties who have suffered financial loss immediately look for compensation to the deep-pocket professional advisors." *Id.* (quoting Robert O'Malley). See also DeBenedictis, *supra* note 2, at 34 (recognizing "deep-pocket" theory as motivation to initiate claims against lawyers); Gillers, *supra* note 59, at 9 (explaining factors which make attorneys and firms attractive defendants, including notion that sizeable insurance carried by firms furthers "deep-pocket" rationale); Reycraft, *supra* note 2, at 606-08 (same); *supra* note 50 and accompanying text (same).

### B. Impact of the Trend

Attorneys who find their clients engaged in improper activities are at a severe disadvantage.<sup>69</sup> Withdrawal or disclosure of such activities may lead to substantial loss of income for the firm, or loss of employment for corporate counsel; however, inaction leads to possible liability and damage to attorney reputation.<sup>70</sup>

It is submitted that increased corporate lawyer liability poses a threat not only to the attorney, but to the client as well. Attorneys may become overly cautious in giving advice, particularly concerning business decisions, for fear that their actions will exceed that which is permitted as counsel.<sup>71</sup>

It is further submitted that such liability poses a threat to the relationship of attorney and client and the attorney-client privilege. The attorney-client privilege and confidential relationship is diminished when a lawyer, fearing involvement with unethical activities and liability, discloses a fraud or withdraws from a representation since mere withdrawal leads to curiosity.<sup>72</sup>

<sup>69</sup> See *infra* note 70 and accompanying text (discussing impact of liability trend on lawyers).

<sup>70</sup> See Burke, *supra* note 54, at 264-65. Lawyers are faced with a difficult dilemma when deciding whether to disclose a client's "arguably illegal scheme." *Id.* at 264. Outside counsel confronts the possibility of losing important revenue producing clients. *Id.* On the other hand, inside counsel must be wary of breaching the client's confidentiality which would lead to an attorney's "loss of livelihood." *Id.* See also Marcus, *supra* note 11, at B1. "[D]efending itself against litigation can be a harrowing experience for a firm, which trades on its reputation. Partner may be set against partner, lawyers may defect to other firms, clients may drop the firm or potential clients may stay away." *Id.*

<sup>71</sup> See Marcus, *supra* note 11, at B1. If lawyers are exposed to too much liability, they may become self-protective and begin to put their own interests ahead of their clients. *Id.* See also Gillers, *supra* note 59, at 63-64 (lawyers must be given freedom necessary to fully advise clients without fear of liability).

<sup>72</sup> See *Upjohn Co. v. United States*, 449 U.S. 383, 398 (1981). If the attorney-client privilege is not protected "[i]nefficiency, unfairness and sharp practices would inevitably develop in the giving of legal advice and in the preparation of cases for trial." *Id.* See also *In re Carter & Johnson*, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 82, 147, at 84,172 (Feb. 28, 1981) (lawyer's fear of own liability may result in disclosure and interfere with client's wishes which is not in public interest). See also MODEL CODE OF PROFESSIONAL RESPONSIBILITY, EC 4-1 (1969). "Both the fiduciary relationship existing between lawyer and client and the proper functioning of the legal system require the preservation by the lawyer of confidences and secrets of one who has employed or sought to employ him." *Id.* Disciplinary Rule 4-101(C)(3) states that an attorney may reveal his client's intention to commit a crime. Morgan, *The Evolving Concept of Professional Responsibility*, 90 HARV. L. REV. 702, 739 (1977). This exception to the attorney-client privilege is the only one which "serves the public's interest without also serving the attorney's [interest]." *Id.* See generally Burke, *supra* note 54, at 264. "Revealing confidential information is a treachery, a betrayal

In contrast, it is suggested, that the attorney liability trend may be a necessary phenomenon despite its harsh results. It is submitted that the attorney-client relationship and privilege is undermined when the client uses it as a shield behind which he can perpetrate fraud without fear of public discovery from attorney disclosure. The protection provided by the attorney-client privilege was never intended to protect a fraudfeasor and, as such, should not be utilized by a client to perpetrate a fraud.<sup>73</sup>

### C. *Proper Action for Avoidance of Liability*

Experts in the field of advising attorneys on how to avoid malpractice suits and unnecessary participation in a corporate client's fraud, stress that attorneys should not be overly trusting of a client and that they should make inquiries into the client's actions.<sup>74</sup> Law firms should adopt policies which prohibit attorneys from sitting on the board of directors and from maintaining a financial interest in their corporate clients since these are the attorneys most frequently in trouble.<sup>75</sup> Law firms should adopt a strategy

of trust, and a breach of fiduciary duty of loyalty, besmirching the attorney's honor and trustworthiness." *Id.* But See Frank, *A Higher Duty: A New Look at the Ethics of the Corporate Lawyer*, 26 CLEV. ST. L. REV. 337, 353-364 (1977) (attorney-client privilege must be weighed against interests of third parties affected by fraudulent acts).

<sup>73</sup> See Burke, *supra* note 54, at 264. A client who has used his attorney-client relationship for wrongful purposes is the primary actor in betrayal of the relationship and "should not benefit from the protection of his confidences." *Id.* See also Note, *Client Fraud and the Lawyer-An Ethical Analysis*, 62 MINN. L. REV. 89, 90-91 n.9 (1977) (fraudulent client not deserving of attorney-client privilege because it would be abusive of attorney's skills).

"It is . . . clear . . . that a lawyer is not privileged to unthinkingly permit himself to be coopted into an ongoing fraud and cast a dupe or a shield for a wrong doing client." *In re Carter & Johnson* [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 82, 147 at ¶ 84,172 (Feb. 28, 1981).

<sup>74</sup> See *Takeover, Insider Trading Themes Pervade Annual Garrett Conference*, 19 Sec. Reg. & L. Rep. (BNA) at 687 (May 8, 1987). Robert O'Malley, Loss-Prevention Counsel for the Attorney Liability Assurance Society, advised not to assume that clients will not engage in criminal misconduct - referring to "world class felons" such as J. David Dominelli and Ivan Boesky. *Id.* He reminded attorneys to keep their eyes open since the most significant problem arises when a client commits a violation and uses the attorney as an "instrument" to do so. *Id.* Attorney liability, he feels, is most prevalent in the securities and real estate areas. Tabac, *supra* note 8, at 50, col. 2.

<sup>75</sup> See O'Brien, *supra* note 21, at 67. Prestigious law firms, tearing liability, have increasingly adopted written guidelines for their attorneys regarding equity ownership in a corporate client. *Id.* The Attorney Liability Assurance Society (ALAS) adheres to a policy which bars partners from sitting on the board or being officers of corporate clients. *Id.* The ALAS does not bar equity participation, but does discourage it. *Id.* One New York-based

which will continually keep their attorneys, including the partners, in check.<sup>76</sup>

It is suggested that the above preventive strategies should be cautiously heeded in order to avoid the difficult and inadequately guided position of an attorney who discovers a client's fraudulent activity. The Model Rules of Professional Conduct issued, and the SEC acknowledged,<sup>77</sup> very general guidelines directing attorney action when a client's improper conduct is discovered.<sup>78</sup> The Model Rules state that an attorney, upon discovering a client's wrongful action, should first advise the corporation to correct the action and to take reasonable steps to dissuade his client from continuation of these actions.<sup>79</sup> If unsuccessful, the attorney may re-

professional liability lawyer noted: "It's the young, aggressive, fast-rising star that causes, disproportionately, up to ninety percent of these problems. It's the fast-rising cowboy." *Id.*

<sup>76</sup> See *Takeover, Insider Trading Themes Pervade Annual Garrett Conference*, *supra* note 74, at 686. O'Malley noted that very close review is needed on a partner-to-partner basis. *Id.* He discussed a partner peer review that would be similar to the common practice of overseeing the work of associates. *Id.*

<sup>77</sup> See *In re Carter & Johnson* [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 82,147 at ¶ 84,170 (Feb. 28, 1981). Although the SEC has not adopted the Model Rules, they are considered "generally recognized norms of professional conduct." *Id.*

<sup>78</sup> See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(b)(c) (1983). These guidelines, although somewhat inefficient, offer the clearest existing official direction to the corporate attorney who discovers a faulty action by his client. See Rotunda, *The Notice of Withdrawal and the New Model Rules of Professional Conduct: Blowing the Whistle and Waving the Red Flag*, 63 OR. L. REV. 455, 455-56 (1984) [hereinafter Rotunda, *Notice of Withdrawal*]. The Model Code of Professional Responsibility is confusing as to what the attorney's ethical responsibility entails. *Id.* The Model Code speaks only to lawyers in a litigation context. See Reycraft, *supra* note 2, at 607-08.

<sup>79</sup> MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(b)(c). The rule states in pertinent part that:

(b) if a lawyer for an organization knows that an officer . . . [or] employee is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law . . . the lawyer shall proceed as is reasonably necessary in the best interest of the organization . . . . Such measures may include among others:

(1) asking reconsideration of the matter; (2) advising that a separate legal opinion . . . be sought; and (3) referring the matter to higher authority in the organization . . . .

(c) if, despite the lawyer's efforts in accordance with paragraph (b), the highest authority that can act on behalf of the organization insists upon action, or a refusal to act, . . . the lawyer may resign in accordance with Rule 1.16.

*Id.* See *In re Carter & Johnson*, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 82,147 at ¶ 84,145 (Feb. 28, 1981) (SEC's version of proper action). See also Reycraft, *supra* note 2, at 612 (discussing sample actions to dissuade corporate wrong). See generally Smith, *Disclosure Problems of Companies and the Responsibilities of Counsel*, 1 SEC. REG. L.J. 34 (1973) (overview of contemporary cases regarding disclosure problems faced by attorneys).



sign.<sup>80</sup> Disclosure is prohibited where the information concerning a previously committed fraud is protected by the attorney-client privilege.<sup>81</sup>

It is suggested that a more complete set of official guidelines are necessary because expert-advised preventive strategies are mere suggestions. Furthermore, the Model Rules are vague, and leave too much to the judgment of a potentially liable attorney who discovers a client's wrong.

## CONCLUSION

The trend of lawyer liability for wrongs of corporate clients is a very real phenomenon. Lawyers are increasingly labelled "aiders and abettors" of various corporate wrongs. Although unguided in their responsibilities, lawyers are increasingly liable for the illegal activities of their clients. Today's corporate lawyer carries the insurance, the business image and often the power within the corpo-

<sup>80</sup> See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(c) *supra* note 79.

Upon resignation, the attorney should give notice of withdrawal and so alert the world of a not so innocent operation. See Rotunda, *Client Fraud: Blowing the Whistle, Other Options*, 24 TRIAL 92, 96-97 (Nov. 1988) [hereinafter Rotunda, *Client Fraud*] (discussing need to avoid liability by disclosing); Rotunda, *The Notice of Withdrawal* *supra* note 78, at 478-80 (discussing proper attorney action upon notice of withdrawal).

Comment 1.6 of the Model Rules of Professional Conduct provides: "Neither this rule nor Rule 1.8(b) nor Rule 1.16(d) prevents the lawyer from giving notice of the fact of withdrawal, and the lawyer may also withdraw or disaffirm any opinion, document, affirmation, or the like." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 comment (1984) (withdrawal).

One commentator construed Rule 1.6 as enabling "the lawyer [to] give a sufficient signal that the transaction is smelly, so long as he does not reveal the information upon which he reached the conclusion that he should give such a signal." Hazard, *Rectification of Client Fraud: Death and Revival of a Professional Norm*, 33 EMORY L.J. 271, 303 (1984).

<sup>81</sup> See MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 4-101 (1969). This rule maintains that an attorney may not reveal information obtained in a privileged relationship with the client. *Id.* Although this privilege is highly guarded it is subject to exceptions such as disclosure permitted for intent to commit a crime as listed in Disciplinary Rule 4-101(C). MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 4-101(C) (1969). See also MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 4 (1980) (attorney must preserve confidences of client).

In 1981, the Securities Exchange Commission backed away from a mandatory duty of disclosure. *In re Carter & Johnson*, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 82,147 at ¶ 84,169 (Feb. 28, 1981). See generally Rotunda, *Client Fraud*, *supra* note 80, at 92-97 (discussing proper action to be taken by attorney upon discovery of client fraud); Hazard, *supra* note 80, at 296-306 (discussing development and acceptance of ABA guidelines for proper action); Rotunda, *Notice of Withdrawal*, *supra* note 78, at 471-84 (discussion of Model Rules).

ration to be targeted as a defendant. This trend has a threatening, but somewhat necessary, effect on the attorney and client as individuals, as well as on the attorney-client privilege and relationship.

Colleen Graham

### RULE 11 SANCTIONS: THE SUPREME COURT GIVES RULE 11 A STRONGER BITE AND A LONGER LEASH

In its original form, Rule 11 of the Federal Rules of Civil Procedure established that an attorney's signature on a pleading constituted a certification that to the best of the attorney's "knowledge, information and belief there is good ground to support it, and that it is not interposed for delay."<sup>1</sup> The rule was promulgated to

<sup>1</sup> FED. R. CIV. P. 11, 28 U.S.C.A. R. 11 (1938). The following text illustrates the additions and deletions of the 1983 amendment (italics show additions, brackets deletions):

Rule 11. Signing of Pleadings, *Motions, and Other Papers; Sanctions* Every pleading, *motion, and other paper* of a party represented by an attorney shall be signed by at least one attorney of record in his individual name, whose address shall be stated. A party who is not represented by an attorney shall sign his pleading, *motion, or other paper* and state his address. Except when otherwise specifically provided by rule or statute, pleadings need not be verified or accompanied by affidavit. The rule in equity that the averments of an answer under oath must be overcome by the testimony of two witnesses or of one witness sustained by corroborating circumstances is abolished. The signature of an attorney *or party* constitutes a certificate by him that he has read the pleading, *motion, or other paper*; that to the best of his knowledge, information and belief [there is good ground to support it; and that it is not interposed for delay] *formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.* If a pleading, *motion, or other paper* is not signed, it shall be stricken unless it is signed promptly after the omission is called to the attention of the pleader or movant. [or is signed with intent to defeat the purpose of this rule; it may be stricken as sham and false and the action may proceed as though the pleading had not been served. For a wilful violation of this rule an attorney may be subjected to appropriate disciplinary action. Similar action may be taken if scandalous or indecent matter is inserted.] *If a pleading, motion, or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, shall impose upon the person who signed it, a represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, motion, or other paper, including a reasonable attorney's fee.*

Proposed Amendment FED. R. CIV. P. 11, quoted at 97 F.R.D. 196-97 (1983).